



To:       Members of the Investment Committee  
            California Public Employees' Retirement System

From:     Pension Consulting Alliance, Inc. (PCA)

Date:     March 3, 2009

Subject:  Real Estate Performance through December 31, 2008

PCA has received and reviewed Wilshire's Fourth Quarter 2008 Executive Summary of CalPERS' Investment Performance as it relates to the Real Estate Portfolio. The following items should be considered in your assessment of Real Estate's performance:

- In an illiquid asset class populated with ten-year partnerships, longer term results are more significant than those of a shorter duration.
- As a result of the dislocation in global financial markets, including the commercial real estate mortgage market, real estate transactions have ground to a halt during the past year. Because there have been so few relevant market comparable transactions available for appraisers to use to understand asset pricing, the tendency of real estate valuations to lag the market has been exacerbated.
- While the Core portfolio outperformed the policy benchmark over all periods, CalPERS' Total Real Estate portfolio lags the policy benchmark due to large exposures to the housing sector and other opportunistic real estate. PCA expects these results to continue during the foreseeable future.
- PCA expects the performance of the Real Estate portfolio to deteriorate significantly over the next 12 to 18 months as weak economic conditions erode income streams and total returns incorporate larger write downs, particularly in the portion of the portfolio invested in more highly leveraged, opportunistic investment properties.
- Staff has initiated a rigorous review of all real estate partnerships to evaluate the risks and merits of individual investments and investment managers. Information from this review process will be used to guide the restructuring of the portfolio and will be shared with the Investment Committee on a regular basis.
- While punishing to currently held investments, the dislocation in the markets creates tremendous investment opportunities, and PCA is working with Staff to evaluate opportunities for CalPERS to participate in these unique situations.



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